CHRISTIAN | BARTON, LLP
Attorneys At Law

Phone: 804-697-4120
Fax: 804-697-6120
E-mail: lmonacell@cblaw.com

Phone: 804.697.4135
Fax: 804.697.6395
E-mail: epetrini@cblaw.com

May 28, 2003

David M. Eichenlaub
Division of Economics and Finance
State Corporation Commission
1300 East Main Street
Richmond, VA 23219

Re: Comments Concerning the Status of Competition -- Compliance by the State Corporation Commission with § 56-596.B of the Code of Virginia

Dear Mr. Eichenlaub:

Thank you for your letter of April 16, 2003, requesting comments on various topics pursuant to Virginia Code § 56-596.B relating to the status of competition in Virginia.[1] We respond on behalf of the Virginia Committee for Fair Utility Rates and the Old Dominion Committee for Fair Utility Rates (collectively, "the Committees"), which consist of large industrial customers of Virginia Power and AEP-Virginia, respectively. The Committees have a vital interest in the development of competition in Virginia and in the region.

I. INTRODUCTION

In Virginia at present, retail competition for generation services essentially does not exist. With the exception of a miniscule number of customers that purchase power at above-market rates from a competitive service provider ("CSP") that has stopped offering the service to new customers, there is no retail competition at all. Thus, in terms of the existence of retail competition, little, if anything, has changed since last year, when, in response to the Commission's inquiry into the status of competition, the Committees submitted comments, dated May 28, 2002 ("Committees' 2002 Comments"), that offered a number of suggested remedies for the dearth of retail competition in Virginia. The chart below summarizes key suggestions in those comments and their subsequent disposition.

[1] Section 56-596.B of Virginia's Electric Utility Restructuring Act ("Restructuring Act"), Va. Code § 56-596.B, requires the Commission to recommend actions to be taken by the General Assembly, the Commission, electric utilities, suppliers, generators, distributors and regional transmission entities that the Commission considers to be in the public interest, including actions regarding the supply and demand balance for generation services, new and existing generation capacity, transmission constraints, market power, suppliers licensed and operating in the Commonwealth, and the shared or joint use of generation sites.

COMMITTEES' PROPOSALS	DISPOSITION
Wires Charges. **Remedy the lack of headroom for customers of Virginia Power by reconsidering the legal conclusions on which the present methodology for the calculation of wires charges is based.** **Adopt a new methodology using projected retail market prices for generation.**	The SCC reiterated its prior legal conclusion in its report to the General Assembly, dated August 30, 2002 ("2002 Report"), and, in its Final Order in the wires charges case, dated October 11, 2002.[2] In the latter order, the SCC declined to adopt a new methodology that uses projected retail market prices for generation.
Wires Charges. **If, upon reconsideration, the SCC reached the same legal conclusions, it should recommend to the General Assembly amendment of the Restructuring Act to clarify that its discretion in determining the projected market price of generation is not constrained by the goal of achieving "revenue neutrality."**	The SCC declined to make such a recommendation in its 2002 Report. The SCC recommended in the 2002 Report that the General Assembly consider amending the Act to allow a large commercial or industrial customer that is willing to commit to market-based pricing should it ever return to its incumbent utility, the ability to switch to a CSP without paying a wires charge.[3] (Legislation, SB 891, subsequently was introduced in the General Assembly but did not pass.)
Wires Charges. **Deny requests by utilities to subtract from the Commission's projected market prices for generation the cost of transmission that could have been avoided if they had joined or established a regional transmission organization ("RTO" or "RTE).**	The SCC denied AEP-Virginia's request on other grounds but granted Virginia Power's request for a transmission cost adjustment. Neither utility has joined or established an RTO.[4] (The General Assembly later amended the

[2] *Commonwealth of Virginia at the Relation of the State Corporation Commission Ex Parte: In the matter of considering requirements relating to wires charges pursuant to the Virginia Electric Utility Restructuring Act*, SCC Case No. PUE-2001-00306 ("Wires Charges Case"), Final Order, dated October 11, 2002, at 5, 6; 2002 Report at 20-23.
[3] 2002 Report at 65.
[4] Wires Charges Case, Final Order, dated October 11, 2002, at 22.

	Restructuring Act to prohibit utilities from transferring control of transmission assets to an RTO prior to July 1, 2004.)
***Alleged Stranded Costs*. Analyze whether the existence and amount of "just and reasonable net stranded costs" warrant the recovery of such costs through wires charges.**	The LTTF adopted a resolution requesting the Commission to establish and convene a work group to develop "consensus" recommendations among interested persons regarding a definition of just and reasonable net stranded costs and methodologies for their calculation and recovery; however, utility members of the work group have urged, in essence, that neither just and reasonable net stranded costs nor their recovery under capped rates and wires charges be estimated.
***RTOs*. Consider instituting show-cause hearings to require compliance by Virginia Power and Appalachian Power Company with their obligations, as incumbent electric utilities under the Restructuring Act, to join or establish a regional transmission "entity" on or before January 1, 2001.**	The SCC recommended, in a supplement to the 2002 Report, that the General Assembly decide promptly whether to proceed with or delay implementation of the Act (including retail customer choice), citing the FERC's proposed standard market design ("SMD") rulemaking, worsening financial distress among utilities subject to restructuring, merchant generators, and competitive retail suppliers, as well as the lack of development of retail electric choice in the U.S., including Virginia. The General Assembly enacted HB 2453, which, *inter alia*, eliminated the January 1, 2001, deadline and prohibited utilities from transferring control of transmission to an RTO prior to July 1, 2004.
***Fuel*. To ensure that CSPs have sufficient advance knowledge of the "price to beat," establish fuel factors and wires charges well in advance of September 1 of each year.**	The 2002 Report does not propose to change the schedule for establishing fuel factors and wires charges, and the SCC has not adopted any changes in the schedule previously adopted in its wires charges and fuel factor orders.[5]

[5] Id., Final Order, dated November 19, 2001, at 27; Final Order, dated October 11, 2002, at 13; 2002 Report at 24 (explaining that the annual July 1 filing date for fuel factor applications and applications for wires charges for utilities wishing to impose them is to allow wires charges determinations to be "finalized" in October).

***Fuel.* Discontinue annual re-calculation of fuel factors and wires charges; consider fixing them for two or three years.**	While acknowledging that the proposal "may have merit," the 2002 Report stated that "it is unclear" that the proposal would "accomplish the goal of advancing competition" and further stated that legislation "appeared" to be required to allow a fuel factor to be set for more than one year.[6] The SCC in its order authorizing Virginia Power's 2003 fuel factor later rejected a proposal to "freeze" Virginia Power's fuel factor stating that the proceeding "did not encompass the notice required by § 56-249.6 prior to dispensing with the adjustable fuel factor"; however, the SCC noted that "such a fixed fuel factor may have certain merits, including increased judicial economies, changed incentives on the part of DVP, and increased electricity cost certainty for customers during the freeze period. As such we remain open to proposals of this nature."[7]
***Fuel.* Consider time-of-use fuel factors – *e.g.*, fuel factors that would vary by season – as an alternative to the use of single fuel factor as a means of "matching" more closely wholesale and retail prices, allowing CSPs more opportunities because their headroom during each season would be more closely tied to the wholesale market.**	The 2002 stated that the SCC "stands ready to investigate reasonable proposals that may provide improved regulated price signals," and it noted that, in a recent order, it encouraged a work group assisting Staff to study the possibility of utilities establishing (and/or expanding) voluntary time-of-use rate programs.[8]

[6] 2002 Report at 25. The report quotes from the provisions of Va. Code § 56-249.6, which requires each utility that purchases fuel for generation of electricity to submit to the Commission its estimate of fuel costs for the twelve-month period beginning on the date prescribed by the Commission and requires the Commission, upon investigation, to direct each company to put in place tariff provisions designed to recover the fuel costs determined by the Commission to be "reasonable for that period …" *But see* Va. Code § 56-582.B, which authorizes the Commission, "[n]otwithstanding § 56-249.6," to "authorize tariffs that include incentives designed to encourage an incumbent electric utility to reduce its fuel costs by permitting retention of a portion of cost savings resulting from fuel cost reductions or *by other methods determined by the Commission to be fair and reasonable to the utility and its customers*." (Emphasis added.)

[7] *Application of Virginia Electric and Power Company to revise its fuel factor pursuant to Va. Code § 56-249.6*, SCC Case No. PUE-2002-00377, Order Establishing 2003 Fuel Factor, dated October 16, 2002, at 5.

[8] 2002 Report at 42. The SCC also noted that it would be hesitant to reallocate fuel cost responsibility among rate classes in light of the Restructuring Act's capped rate provisions.

***Transmission.* Obtain data on transmission constraints and load pockets for Virginia's utilities.**	The 2002 Report stated that, in accordance with § 56-578 G of the Restructuring Act, the SCC "would be responsible for monitoring market power over the sale of electric generating capacity or energy to retail customers." It noted, however, that, "to the extent that market power is exercised by a generating facility dispatching into a wholesale market, the mitigation of that market power will likely be the responsibility of the" FERC.[9] The Report stated that the SCC "will perform its statutory obligations under § 56-578 G with respect to market power exercised in Virginia's retail markets. In doing so, it might retain the use of a consultant." The 2002 Report also described the Energy Infrastructure Study underway pursuant to Senate Bill 684, which was enacted in the 2002 Session of the General Assembly and which required the SCC to convene a work group to " …study the feasibility, effectiveness, and value …" of collecting information relative to energy infrastructure facilities, including electric transmission facilities.[10] The SCC's report of November 20, 2002, to the LTTF, submitted pursuant to SB 684, stated that "given the ongoing evolution of the electric utility industry and potential for significant jurisdictional shifts relative to the oversight of Virginia's generation/transmission reliability, it is "difficult to make absolute statements as to the *value/effectiveness* of collecting this information."[11] The report further stated that "basic information" relative to *generation* adequacy could be collected;

[9] 2002 Report at 64.
[10] Id., at 56.
[11] *Report to the Legislation Transition Task Force of the Virginia General Assembly: The Feasibility, Effectiveness, and Value of Collecting Data Pertaining to Virginia's Energy Infrastructure Pursuant to Senate Bill 6684 Enacted by the 2002 Session of the General Assembly of Virginia, dated November 20, 2002*, at 17.

	[d]ata relative to transmission facilities could also be provided if the need for more detailed information arises." The report stated that this "flexible approach may be more practical in the current environment and would certainly be less burdensome to those entities providing the information."
***Minimum Stay*. Permit customers that shop and return to the incumbent to pay the incumbent a market-based price, instead of capped rates, upon return in order to avoid the 12-month minimum stay requirement.**	The 2002 Report agreed that the proposal has merit, concluded that legislation may be required to implement it, and recommended that the General Assembly consider whether an amendment is needed to permit it.[12] (Legislation, SB 892, subsequently was introduced in the General Assembly but did not pass.)
***Demand side options*. Permit customers to receive, on a voluntary basis, more accurate price signals so that they may adjust their demand accordingly and receive market-based compensation for doing so.**	The 2002 Report does not adopt the recommendation.
***Generation*. Grant expeditious and favorable treatment to applications for the construction of new generation that will assist in the development of competition.**	The 2002 Report reviews the signing of the memorandum of agreement between the SCC and the Department of Environmental Quality regarding coordination of reviews of the environmental impact of electric generating plants and associated facilities. Since the report, the SCC has issued a number of orders approving the construction of additional generation in Virginia.[13]

[12] Report at 26, 65.
[13] See, for example, *Application CPV Cunningham Creek, LLC, For a certificate of convenience and necessity pursuant to Va. Code § 56-265.2 for an exemption from Chapter 10 of Title 56, and for interim authority to make financial expenditures*, SCC Case No. PUE-2001-00477, Final Order, dated October 7, 2002; *Application of Tenaska Virginia II Partners, L.P., For a certificate of convenience and necessity pursuant to Va. Code § 56-265.2, an exemption from Chapter 10 of Title 56, and interim approval to make financial commitments and undertake preliminary construction work*, SCC Case No. PUE-2001-00429, Final Order, dated January 9, 2003; *Application of CPV Warren, LLC, for a certificate of convenience and necessity for electric generation in Warren County, Virginia*, SCC Case No. PUE-2002- 00075, Final Order, dated March 13, 2003.

II. COMMENTS AND RESPONSES TO QUESTIONS

We address below the questions posed in your letter that appear to be of particular importance to the Committees.

1. ***What are the current obstacles to the development of a robust competitive retail electricity market for residential customers? For commercial and industrial customers? How can these obstacles be overcome?***

As indicated, the Committees' 2002 Comments identified and discussed key obstacles to the development of a robust competitive retail electricity market in Virginia. Obstacles included the lack of "headroom" for CSPs, transmission constraints, the adequacy of generation not owned by incumbents, and the lack of a regional transmission entity ("RTE" or "RTO"). Such obstacles remain. As indicated above, the Committees' 2002 Comments suggested a number of remedies for alleviating or removing them. With the possible exceptions of the working group on stranded costs, commenced pursuant to the LTTF's resolution of January 27, 2003, which has begun investigating that subject, and the recent orders granting approval to the construction of generation, none of the suggested remedies has been implemented.

Importantly, the Committees' 2002 Comments contended that the current methodology for the calculation of wires charges represents a significant obstacle for Virginia Power's customers and that that methodology is flawed because it requires would-be competitors to provide generation at retail prices significantly below prevailing wholesale prices. The comments urged the Commission to reconsider the legal conclusions on which the present methodology is based and adopt a new approach that would permit competition to develop.

In the Commission's 2002 Report, and in its Final Order, dated October 11, 2002, in the Wires Charges Case, the Commission reiterated its prior position that "revenue neutrality" is intended by the Act. Accordingly, it has left the current methodology essentially undisturbed.

The Committees recommended in their 2002 comments that if upon reconsideration the Commission reached the same legal conclusion, it should recommend amending the Restructuring Act to clarify that its discretion in determining the projected price of generation is not constrained by the goal of achieving "revenue neutrality." The Commission's 2002 Report, however, did not include such a recommendation. The Report instead suggested that wires charges be eliminated for large customers willing to forego their current right to return to the incumbent's capped rates upon terminating service with a competitive supplier. While the Commission's recommendation, if adopted, probably would have improved the outlook for competitive entry, no such legislation was enacted.

In a supplement to its 2002 Report, the Commission recommended that a decision by policymakers be made on whether customer choice should be suspended, along with Virginia utilities' then-existing obligations to join regional transmission entities. While the General

Assembly did not suspend customers' right to choose under the Restructuring Act, it did enact House Bill 2453, which amended the Act, among other things, by (i) eliminating the January 1, 2001, deadline by which incumbent electric utilities with transmission capacity were to join or establish an RTO; (ii) prohibiting such utilities from transferring ownership or control of, or operational responsibility over, any transmission system to any person prior to July 1, 2004; and (iii) modifying the standards to be applied by the Commission in approving such transfers.

Enactment of HB 2453 may delay RTO membership for Virginia utilities that have not already joined an RTO; it is unlikely to hasten the development of competition. Recommendations for suspension of customer choice will not do so. In sum, with the major obstacles identified by the Committees still in place, with few efforts underway to alleviate or remove them, and with enactment of HB 2453 and proposals for suspending the right to choose, the present absence of retail competition is likely to continue.

2. ***With respect to potential obstacles, what is the outlook for future natural gas prices and the impact on wholesale electricity prices and a competitive retail market? Please comment on the postulation by several natural gas industry experts of a growing structural demand/supply imbalance with demand outstripping supply over the next several years. What actions, if any, could be taken to mitigate the potential impact of an over-dependence on a single fuel source?***

The Committees have not prepared a projection of future natural gas prices; however, they are acutely aware of the recent increases and the views of some observers that a structural change in the natural gas market has occurred such that higher-than-historic prices can be expected in the future. Virginia's Restructuring Act does not provide for a remedy, other than market forces, for over-dependence upon a single fuel source.

3. ***In light of recent legislation, how can the Commonwealth be assured of a continuing reliable electricity system when control of transmission is governed by an RTO? What factors should be considered during the cost/benefit analysis required prior to Commission approval?***

The new Virginia legislation, House Bill 2453, requires the Commission to develop rules under which incumbent electric utilities owning, operating, controlling, or having an entitlement to transmission capacity in Virginia, may transfer control or ownership to an RTO upon such terms and conditions that the Commission determines are consistent with, among other things, "ensuring that consumers' needs for economic and reliable transmission are met."[14] The Commission's procedural order in response to AEP-Virginia's application to join the PJM

[14] Va. Code § 56-579.A.2.d.(i)

includes a number of requirements that address reliability issues.[15] The order also contains specific requirements for a cost/benefit analysis. The order represents a good start in fulfilling the Commission's revised responsibilities under the new legislation.

As a general matter, membership in an RTO should enhance reliability by easing access to generation sources across an entire region. For that reason, among others, utilities' membership in RTOs has been an important element in Virginia's Restructuring Act.[16]

4. Later this month, the Federal Energy Regulatory Commission is expected to issue its "white paper" addressing certain issues debated the past several months regarding Wholesale Electric Standard Market Design (SMD). Additionally, the Department of Energy is expected to issue the results of its cost/benefit analyses of the impacts of SMD. Please provide your initial thoughts and reaction to such releases and identify any significant issues of concern.

The Committees have not taken a position on the recent "white paper" or reviewed the Department of Energy analysis.

5. Are the Commission's Rules Governing Retail Access to Competitive Energy Services conducive to promoting effective competition in the Commonwealth? If not, how should they be modified? Is there any way in which these rules can or should be improved, in any event?

The Committees have no suggestions at this time for changes in the Commission's Rules Governing Retail Access to Competitive Energy Services.

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[15] *Commonwealth of Virginia At the Relation of the State Corporation Commission Ex Parte: In the matter concerning the application of Appalachian Power Company (d/b/a American Electric Power – Virginia) for approval of a plan to transfer functional and operational control of certain transmission facilities to a regional transmission entity*, SCC Case No. PUE-2000-00550, Order for Notice, dated March 7, 2003, at 11; *see also*, 20VAC5-320-40.

[16] We note that the Federal Energy Regulatory Commission's ("FERC's") recently issued "white paper" in its standard market design rulemaking proceeding addressed resource adequacy and transmission planning. It states that "nothing in the Final Rule will change state authority over these matters [referring to resource adequacy requirement and the regional transmission planning requirement in the proposed standard market design]." *Remedying Undue Discrimination through Open Access Transmission Service and Standard Electricity Market Design*, FERC Docket No. RM01-12-000, White Paper, Wholesale Power Market Platform, issued April 28, 2003, at http://www.ferc.gov. According to the white paper, the RTO or ISO may implement a resource adequacy program "only where a state (or states) asks it to do so, or where a state does not act." (Id.) The white paper states that RTOs and ISOs will be directed to develop a periodic regional transmission plan *for submission to relevant state and local siting authorities* and *to assist* states in whatever manner they desire, including evaluating the impact of new generation, transmission, energy efficiency and demand response on regional reliability and resources adequacy. (Id.) (Emphasis added.)

6. ***What should be the level of consumer education when the program is resumed on July 1, 2004? Should it be as visible, more visible or less visible than when the campaign was suspended? Upon resumption of the campaign, what focus, theme or message should be communicated? Since TV advertising is the most expensive component of the program, what level of TV advertising should be included in the resumption of the campaign?***

The Committees recommend that the consumer education program be less visible until competitive entry of retail suppliers has real prospects to develop in Virginia. No such prospects exist today.

7. ***Are there any other actions that have been taken or are being considered in other states that may be used to advance competitive activity in Virginia?***

See the Committees' response to question 1.

8. ***Do you have any ideas that have not been tried elsewhere that may facilitate competitive activity in Virginia?***

See the Committees' response to question 1.

III. CONCLUSION

The Committees appreciate the opportunity to comment, and they look forward to continuing to assist the Commission in its response to the mandate contained in Va. Code § 56-596.B.

Sincerely,

Louis R. Monacell

Louis R. Monacell

Edward L. Petrini

#637394